Using the Value Chain in Financing Agriculture

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Calvin Miller
FAO Agribusiness and Finance Senior Officer
Rome, Italy
1. The changing agricultural scene
2. Using strategic alliances in financing
3. Value chains as a business approach finance
4. Value chain financing products
5. Lessons and policies
An Evolving Agriculture

- “Supermarketization”
- Market integration and specification
- Conglomeration of market leaders
- Open trade with regional and global competition
- Segmented demand with stringent standards and conditions
- Cell phones, internet and instant access to information
Defining Value Chain Finance

**Value chain finance** – financial products and services flowing to and/or through a VC to address the needs of those involved in that chain, be it a need for finance, a need to secure sales, procure products, reduce risk and/or improve efficiency within the chain.

Objectives:
- Align and structure financial products to fit the chain
- Reduce costs and risks of finance
Supply (or Value) Chain Finance is the next wave of cost improvement for organizations. More than two-thirds of companies are investigating or putting in place Supply Chain Finance programs to improve financial metrics and lower end-to-end costs.

The worldwide market for receivables finance is US$1.3 trillion. Payables discounting is US$100 billion and asset-based lending is US$340 billion.

With the financial and economic crisis, value chain finance is more important than ever.

Ken Shwedel, Rabobank Mexico
Agri Value Chain Stakeholders

Operating Environment

- Input Industry
- Growers
- Transport
- Storage Services
- Food Process Industry
- Food Retail Industry

Agri-Production
Agri-Logistics Industries
Agri-Food Industries

Financial Services
Support Services
Value Chain Analysis Framework

It is a process of identification of

- **Structure** of the value chain: all individuals and firms that conduct business by adding value and helping move the product toward the end markets

- **External** framework, or the broader legal / national context in which the chain operates

- **Dynamics** of the value chain: individual and firm behaviors and how these affect the functioning of the chain
Value Chain Analysis Framework

Structural Factors

• End markets
• Business operating environment
• Vertical linkages
• Horizontal linkages
• Supporting services
• Financial flows and services
Flow of Products and Finance along VC

Value Chain Actors

- Exporters / Wholesalers
- Processors
- Local Traders & Processors
- Producer Groups
- Farmers
- Input Suppliers

Financial Service Institutions

- Banks
- Non-bank Financial Institutions
- Private Investors & Funds
- Cooperatives / Associations
- Local MFIs / Community Orgs

Support Services

- Technical Training
- Business Training
- Specialized Services
- Governmental Certification/Grades

Product Flows

Financial Flows
Example: Flow of finance in rice

- **Asia**
  - Farmers
  - Buyer or agent
  - Millers
  - Wholesalers
  - Retailers

- **Latin America**
  - Farmers
  - Buyer or agent
  - Millers
  - Wholesalers
  - Retailers

- **Africa**
  - Farmers
  - Buyer or agent
  - Millers
  - Wholesalers
  - Retailers
VCF: Demand side

Demand

Input suppliers
- Seeds, fertilizers, pesticides, livestock feed, medicines, farm equipment

Growers
- Farmers, dairy units, fisheries and other livestock growers

Storage & warehousing
- Storage facilities for grains, fruits, vegetables; cold chains & logistics

Processors
- Processing plants, packaging facilities etc.

Retailers & wholesalers
- Inventory, trading & marketing

Exporters
- Pre & post-shipment commitments

Needs of finance
Financial Intermediaries

1. Commercial banks
2. Credit unions
3. Co-op banks
4. Agriculture & Dev. banks
5. Microfinance institutions
7. Leasing companies
8. Insurance companies
9. Venture capital investors
10. Private investor funds

Non-Financial Intermediaries

1. Input suppliers
2. Equipment suppliers
3. Marketing companies
4. Traders & wholesalers
5. Exporters
6. Lead farms/firms
7. Corporations
8. Farmers’ organisations
9. Producers’ companies
10. Family & friends

Governmental subsidies on inputs and exports and tax incentives may also contribute as a source of finance.
Business models in agriculture value chains in terms of small holders can be divided into four types:

- Producer-driven
- Buyer-driven
- Facilitator-driven
- Integrated
TechnoServe’s Model
• Supporting a service provider to provide marketing support and financial partnerships with farmer groups
• Identify and organize farmers' groups with the potential to produce quality
• Help groups to improve production quality
LAFISE Integrated VCF Model

1. Identify organized producers

2. Financing:
   * Asset management
   * Warehouse receipts

3. Technical Assistance
   Quality Certification

4. Consolidation
   Processing Added Value
   Product in storage

5. LAFISE Trade
   Certification of Deposit and Warrants

6. Collection and payment to producer

Identify markets and buyers
Place Products
Network of offices in 10 countries

Technical Assistance Quality Certification
Insurance - transport, life, fire, etc.
Product cosecha
Seguros LAFISE
Collection and payment to producer
1. Product Financing
2. Receivable Financing
3. Physical Asset Collateralization
4. Risk Mitigation Products
5. Financial Enhancements
1. Product Financing

1.a) Trader Credit

1.b) Input Supplier Credit

1.c) Marketing Company Credit

1.d) Lead Firm Financing
Trader Credit

Inputs/Importer/

Large Scale Trader

Exporter/

Input supplier/Small Scale Trader/

Farmers/Farmer Organizations

Trade credit

Trade / seasonal credit

Product sales

Input sales

Wholesaler

Wholesaler or Processor
2. Receivable Financing

2.a) Trade Receivable Finance

2.b) Factoring

2.c) Forfaiting
Factoring

Domestic Factoring

1. Sale of products
2. Invoice certified
3. Receivables sold (at a discount)
4. Notification of factoring
5. Advance by Factor
6. Billing on expiry of term
7. Payment of invoice
8. Final Settlement
3. Physical Assets Collateralization

3.a) Warehouse Receipts

3.b) Financial Lease (Lease-purchase)

3.c) Repurchase Agreement (Repos)
Field Warehouse Receipts

1. Deposit Commodity

2. Third Party/Own Warehouse

3. WR issued by collateral mgr.

4. Pledging WR

5. Financing

Bank

Banker

Collateral Manager

Farmer/Trader

Warehouse
4. Risk Mitigation

Products

4.a) Insurance

4.b) Forward contracts

4.c) Futures
Tools to Mitigate Market Risks

- Use of futures and options
- Warehouse receipt finance
- Market information services
- Contract farming
- Insurance
- Access to technical assistance

Some risk management tools are more practical for agro-industries and wholesalers, but can stabilize prices and reduce risks for all producers and bankers.
5. Financial Enhancements

5.a) Securitization Instruments

5.b) Loan Guarantees

5.c) Joint Venture Finance
Risk Analysis: Incorporating New Elements

- Client/business capacity
- Cash flow
- Market as well as client risk
- Competitiveness
- Repayment capacity
- Security coverage

From supply-driven “how we lend” to client driven “how can we structure finance to address client needs and risks”
Banks are not technical advisors but should invest money & knowledge in the value chains they finance

- market trend knowledge
- understanding of key risks
- alliance and linkage opportunities
Summary: Key Factors for Consideration

- Understanding
  - market and industry
  - client and strategic partners
  - fund the chain at most strategic points

- Administration
  - ensure effective and transparent partnerships
  - innovate with new technologies and products
  - take advantage of the value chain
  - analyze and structure loans properly

- Risk
  - offer timely, multiple and flexible financial services

- Service
  - focus on client and business
Government: Policies to Support VC Finance

- Business capacity building and market integration
- Contract farming and out-grower schemes
- Technical capacity in market norms and standards
- Commodity exchanges and active futures markets
- Insurance innovation, data collection and initiation
- Market information and access
- Infrastructural investment
- Product and service innovation and diversity
- Technology adaptation and access
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Enabling Environment Requirements

- Agriculture extension services
- Strengthened farmer and producer companies/organisations.
- Contract farming and outgrower schemes to build economies of scale for suppliers and for farmer competitiveness
- Promotion of agribusiness as a sub-sector.
- Import and export competitiveness
- Legal structures which ensure fairness
The economic crisis is ending but the food crisis persists. The organization and financing of the agricultural chains will require 860 million small producers to meet the food requirements for the future.

Shwedel, Rabobank
Training: Agri Value Chain Finance Course

Module 1: Overview of Agri Value Chain
Module 2: Financing Agri Value Chain–Context & Concept
Module 3: Business models for Financing Agri Value Chain
Module 4: Products and innovations in financing Agri Value Chain
Module 5: Role of ICT as facilitator in Agri Value Chain
Module 6: Agri Value Chain – Product financing
Module 7: Receivable financing
Module 8: Physical Asset Collateralisation
Module 9: Structured finance in Agri Value Chain
Module 10: Risk Mitigation in Agri Value Chain
Useful Websites

» FAO Agricultural Department
   www.fao.org/ag/ags

» Rural Finance Learning Centre
   www.ruralfinance.org

Thank You